

ST 95-7

Tax Type: SALES TAX

Issue: Books and Records Insufficient

DEPARTMENT OF REVENUE STATE OF ILLINOIS
ADMINISTRATIVE HEARINGS DIVISION
CHICAGO, ILLINOIS

Department of Revenue)	XXXXXX
State of Illinois)	XXXXXX
)	XXXXXX
)	XXXXXX
v.)	XXXXXX
)	
)	Mimi Brin
XXXXXX)	Administrative Law Judge
)	

RECOMMENDATION FOR DISPOSITION

APPEARANCES: XXXXX of XXXXX, for taxpayer, XXXXX; Messrs. Marc . Muchin and Richard A. Rohner, Special Assistant Attorneys eneral, for the Illinois Department of Revenue

SYNOPSIS: This matter comes on for hearing pursuant to XXXXX's (hereinafter referred to as "Chicago", "XXXXXX" or the "Taxpayer") timely protest of Notice of Tax Liability XXXXX (hereinafter referred to as "XXXXXX") issued by the Illinois Department of Revenue (hereinafter referred to as the "Department") on December 28, 1993 for Retailers' Occupation Tax, Municipal Retailers' Occupation Tax and Regional Transportation Authority Tax for the taxable period of November, 1989 through September 30, 1991 (hereinafter referred to as the "Taxable Period"). A civil fraud penalty is also assessed as part of the liability.

At the same time that the Department issued Liability XXXXX, it also issued to XXXXX Notice of Tax Liability XXXXX (hereinafter referred to as "NTL 1007"), for the same taxable period and for the same amount of tax, penalty and interest. However, this second Notice identified the business with a registration number of XXXXX and was sent to a different address

than XXXXX. This second NTL was not timely protested by the taxpayer and thus became a final liability.

This problem of the issuance of two Notices of Tax Liability for the same tax period, for the same amount of liability and for the same taxpayer but under two different registration numbers, one of which the taxpayer was not familiar with, was raised at the hearing by the taxpayer. Following the hearing, the parties jointly requested a late discretionary hearing for XXXXX, which had already become final. The Department granted this request, and by agreement of the parties, XXXXX and 1007 were consolidated, with the evidence presented at the instant hearing applying to both Notices. See, Agreed Order, December 9, 1994 The parties further agreed that this recommendation and the final decision resulting therefrom, applies to both assessments. Id.

The issues presented at this hearing are: 1) whether taxpayer's purchases of potatoes and drinks are properly calculated for inclusion into gross receipts; 2) whether the gross profit margin applied by the Department was appropriate and; 3) whether the civil fraud penalty was appropriate herein. See, Order, November 22, 1994 Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department for each issue.

FINDINGS OF FACT:

1. The Department's prima facie case, inclusive of all jurisdictional elements, was established by the admission into evidence of the Corrections of Returns, showing a total liability due and owing in the amount of \$43,811 exclusive of statutory interest. Dept. Ex. No. 1-4, 10

2. Notices of Tax Liability XXXXX and XXXXX were timely issued by the Department. Dept. Ex. No. 5

3. During the taxable period, taxpayer was an Illinois retailer, in the business of selling various types of sandwiches including hamburgers,

hot dogs and submarine sandwiches, as well as french fries and soft drinks. Tr. pp. 31, 32; Taxpayer Ex. No. 5

4. French fried potatoes and a canned soft drink were included in the purchase price of each sandwich sold. Tr. pp. 38, 52, 57, 66, 91, 130

5. French fries and soft drinks were also separately stated items on taxpayer's printed menus. Tr. pp. 40, 118, 137

6. Taxpayer sold french fries to customers who wished to purchase only french fries and not sandwiches. Tr. pp. 40-41, 52-53, 56, 70, 118

7. Taxpayer sold canned soft drinks to customers who wished to purchase only soft drinks and not sandwiches. Tr. pp. 41, 52, 56, 70, 118

8. Taxpayer sold soft drinks in liter containers, which were not part of a customer's sandwich purchase. Tr. p. 56

9. During the taxable period, taxpayer conducted business under Illinois business registration number XXXXX. Taxpayer Ex. No. 3; Dept. Ex. No. 5, 10

10. During the taxable period, taxpayer was operated as a partnership entity with each of two partners, Messrs. XXXXX and XXXXX, holding 50% ownership. Tr. pp. 74, 126; Taxpayer Ex. No. 1-3, 5

11. Taxpayer did not maintain books and records reflecting its purchases and/or sales. Tr. pp. 93, 95, 113, 129

12. Taxpayer kept no purchase delivery tickets or supplier invoices. Tr. pp. 105, 112, 113

13. Taxpayer paid its suppliers in cash. Tr. p. 96

14. Most of XXXXX customers paid for purchases with cash. Tr. p. 96

15. The Department's calculation of the gross profit margin for this taxpayer for the taxable period at issue is based on the average gross profit margin of another submarine sandwich shop which was 50% owned by one of the partners herein. Tr. p. 101

16. The basis of taxpayer's Retailers' Occupation Tax returns filed

with the Department for the period of November, 1989 through September, 1991 is the general recollection of one of the business' partners regarding business activity for that time period. Tr. p. 110

17. Taxpayer filed the required Retailers' Occupation Tax returns with the Department for the period of November and December, 1989 on July 31, 1991. Dept. Ex. No. 5

18. Taxpayer filed the required Retailers' Occupation Tax returns with the Department for the period of the remaining months of the taxable period after July, 1991. Tr. p. 110

19. At the time of the hearing, there were about three or four fast food or submarine sandwich shops within a one mile radius of XXXXX. Tr. p. 70

CONCLUSIONS OF LAW: On examination of the record established, this taxpayer has failed to demonstrate by the presentation of testimony or through exhibits or argument, evidence sufficient to overcome the Department's prima facie case of tax liability (35 ILCS 120/4) under the assessments in question. Accordingly by such failure, and under the reasoning given below, the determination of tax liability as imposed by the Department on XXXXX must stand as a matter of law. In support thereof, the following conclusions are made:

ISSUE #1: Whether taxpayer's purchases of potatoes and soft drinks are properly calculated for inclusion into gross receipts.

In arriving at XXXXX gross receipts for the taxable period, the Department auditor applied a profit margin to taxpayer's purchases of food, including french fries and soft drinks, set these amounts as gross receipts and then applied the prevailing tax rates to those receipts. Taxpayer Ex. 4 Taxpayer argues that because french fries and soft drinks were included in the purchase price of each sandwich, it is incorrect to apply a profit margin to those particular purchases and then include same in the gross

receipts upon which the pertinent tax rates arecalculated.

Taxpayer's argument in this regard is without merit. Taxpayer's own evidence presented at hearing establishes that although french fries and a can of soft drink were included in the purchase of each sandwich, persons could, and did, order just french fries or a can of soft drink, for which they paid a price separate from that of a sandwich.

Although XXXXX witnesses testified that these particular purchases made up but a small percentage of the total sales, this oral testimony is given no weight for several reasons. First, the two employees who testified were part time employees, only. They each worked sporadic hours and therefore, can not testify as to a regular pattern of customer purchases. Also, these employees have a particular bias in favor of XXXXX partners, in that the partners provided these employees with not only food and lodging, but provided food for their families, also. Tr. pp. 120-121, 128-129

The testimony of the partners in this regard is also not credible. XXXXX testimony regarding mark-up and patterns of customer purchases is testimony from a partner who did not deal with monetary matters, and who was not physically in the store on a regular basis. XXXXX testimony is given no weight because, although he was the partner who handled the monetary matters, he admits to keeping no books, records or bank accounts for this business, nor was he physically on the premises regularly. Thus, his testimony, as he admits, is based upon his recollections and is self-serving at the very least.

The oral testimony in this case is not sufficient in any event to rebut the Department's determination of the amount of the liability. Although I accept as fact that french fries and a can of soda accompanied each sandwich purchased and were included in the selling price, there is nothing of record to evidence that the selling price of the sandwich/fries/drink was not calculated with a consideration of a profit

mark-up of each item comprising each sale. There is also no evidence, oral or otherwise, that when fries or a drink was purchased without a sandwich, that selling price was determined without a profit mark-up. It is not unreasonable to conclude that XXXXX would not sell fries and/or drinks at cost, if for no other reason but that it was a for-profit enterprise. Therefore, the auditor correctly applied a mark up to these products before their inclusion into gross receipts.

Further, well-settled law in Illinois establishes that "[i]n order to overcome the presumption of validity attached to the Department's corrected returns" the taxpayer "must produce competent evidence, identified with their books and records and showing that the Department's returns are incorrect. *Copilevitz v. Department of Revenue*, 41 Ill.2d 154 (1968); *Masini v. Department of Revenue*, 60 Ill. App.3d 11 (1st Dist. 1978) Oral testimony is not sufficient to overcome the prima facie correctness of the Department's determinations. *A.R. Barnes & Co. v. Department of Revenue*, 173 Ill. App.3d 826 (1st Dist. 1988)

Nor can this taxpayer avoid the imposition of its burden of proof by failing to keep any books and records. The keeping of business documentation is mandated by statute (35 ILCS 120/7) and ignorance of the law is no excuse for compliance failure. *DuMont Ventilation Co. v. Department of Revenue*, 99 Ill. App.3d 263 (3rd Dist. 1981)

Therefore, it is my recommendation that the Department's application of a gross profit mark up to taxpayer's french fries and soft drink purchases, followed by the inclusion of that calculation into the gross receipts, be affirmed.

ISSUE #2: Whether the Department applied the correct gross profit margin to taxpayer's purchases of supplies.

XXXXX did not supply the Department with any documentation to support what it claims, through oral testimony at hearing, to be its gross profit

margin of perhaps 25% - 30%. Tr. pp. 102 In the absence of documentation, the Department auditor used the gross profit margin of another submarine shop, owned by one of taxpayer's partners, for application to taxpayer's supply purchases. Tr. p. 101

The only evidence to contradict the appropriateness of this Department procedure is oral testimony at hearing, first regarding the number of similar businesses in the area and XXXXX testimony of his recollections of the differences between his two businesses since no books and records were kept.

Both types of evidence fall considerably short of rebutting the prima facie correctness of the assessment. First, whereas taxpayer's witness, XXXXX, a customer as well as an area resident, testified that there are about three or four fast food and submarine shops within a one mile radius of XXXXX, a former part time employee testified that there were five or six (Tr. p. 60) and the partners testified that there are nine to ten such shops within a one mile radius. Tr. pp. 92, 130. Therefore, taxpayer's own evidence on the matter is inconsistent and does not support a proposition that because of an abundance of competition, taxpayer's profit margin was small.

Additionally, Taxpayer's only evidence concerning the differences between the taxpayer and the other submarine sandwich shop used as the standard for gross profit margin is the oral testimony of the partner with an interest in both businesses, XXXXX. However, his testimony is based upon his memory, not documentation. Not only is this testimony highly suspect because of the interest served, but, again, it is legally insufficient to rebut the correctness of the Department's assessment. *Copilevitz v. Department of Revenue, supra*; *A.R. Barnes & Co. v. Department of Revenue, supra*; *Masini v. Department of Revenue, supra*

Therefore, it is my recommendation that the auditor's methodology of

calculating gross profit margin for this taxpayer for the taxable period be affirmed, with the result being that this assessment be affirmed.

ISSUE #3: Whether the civil fraud penalty is appropriately applied in this instance.

Pursuant to Illinois law at the time of the audit and assessment, a penalty of 30% of the tax due applied upon a Department determination that a taxpayer's returns were incorrect as a result of fraud. 35 ILCS 120/4 The auditor in this matter applied this civil fraud penalty assessment.

During the hearing, taxpayer's partners testified, inter alia, that they did not have high school or college educations, they are foreign born, they were never given instruction on the keeping of books and records for this retail business nor on the filing of the necessary sales tax returns. As a consequence, XXXXX, the partner who managed the taxpayer's finances, kept neither books nor other records and he did not file statutorily required sales tax returns for XXXXX until substantially after the returns were required by law to be filed.

Yet, the partners testified that they, in the company of taxpayer's certified public accountant, went to a Department office to obtain a business registration number when they commenced operations. Tr. pp. 76, 126; Taxpayer Ex. 3 They also obtained the necessary operating documentation for the business from the City of Chicago. Taxpayer Ex. 2

Additionally, XXXXX experience in the food business with submarine shops began in 1986. Tr. p. 109 During the taxable period, XXXXX simultaneously owned at least two and as many as three, retail submarine shops. Tr. pp. 106-107 Not only did XXXXX own such shops, but he sold the instant business late in 1991. Tr. p. 98

The reasonable conclusion from these facts is that XXXXX was actively conducting retail business in Illinois during the taxable period, and had access to and in fact, used, professional assistance in the furtherance of

his businesses. He clearly was not ignorant of Illinois business requirements and practices.

What is striking here is the extent to which taxpayer failed to comply with statutes and regulations. According to the testimony, absolutely no books or records were kept, not even scraps of paper with daily totals on them. Tr. p. 95 Further, according to the evidence, absolutely no returns for the taxable period were filed until years after the fact. The affirmative act of filing monthly returns years late, which are based upon nothing more than the memory of the business conducted, is an intentional act done with full knowledge that the information thereon can not possibly be accurate.

All of this is effectuated by the business partner who had been working in the submarine shop business for a number of years prior to operating this business (Tr. p. 109), who was not even at XXXXX each day during the taxable period (Tr. p. 96, 97), who was in the United States for at least nine years before operating the instant food shop (Tr. p. 109) and who was knowledgeable enough about business to operate multiple submarine shops during the taxable period. Tr. p. 107

As a result of the above, it is simply unreasonable to conclude that taxpayer's failure to comply with pertinent statutes and to correctly report its business activity was a result of lack of formal education and/or lack of specific training. The only reasonable conclusion to be made from the facts above is that taxpayer belatedly reported its business activity to the Department purposefully, fully aware that its representations were without basis. Considering the extreme nature of taxpayer's failure to comply with bookkeeping and record keeping mandates, the only reasonable conclusion to be made from the facts above is that this failure was purposeful or that the taxpayer, again purposefully, kept its business activity documentation away from the Department. In either case,

taxpayer's conduct was willful and the application of the fraud penalty is appropriate.

For the reasons stated above, it is my recommendation that NTL XXXXX, issued to XXXXX under business registration number XXXXX, be finalized as issued. Further, it is my recommendation that NTL XXXXX, for XXXXX under business registration number XXXXX, be cancelled.

Mimi Brin
Administrative Law Judge